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14 January 1975

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MEMORANDUM FOR:

SUBJECT : Argentina: Economic Situation
and Prospects

In response to your request of 13 January, attached
is our review of Argentina's economic situation and
prospects. Further questions may be addressed to Mr.

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Office of Economic Research

Attachment:
As stated

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ARGENTINA: ECONOMIC SITUATION AND PROSPECTS

1. Rises in real wages achieved by several rounds of wage hikes greatly stimulated consumer demand during 1974. The consequent acceleration of private sector activity was reinforced by increased public sector spending and an enlarged deficit to stimulate GDP growth of 6.8% during the first half of the year. While output appears to have leveled off somewhat during the second half, growth remained around 6% for the full year. With the aid of price controls, the cost of living (official index) increased around 40%, compared with about 45% in 1973 and some 60% in 1972. While depressed world beef and wool markets combined with higher costs for oil imports to narrow the trade and payments surplus, high prices and good crops for feedgrains still permitted a gain in foreign reserves of around \$200 million.

2. The rise in real wages contributed to stagnation of corporate profits and consequently, of private investment. Labor gains were largely at the expense of larger firms -- including most foreign subsidiaries -- and black markets and shortages became established facts of economic life. Smaller businesses, however, generally were successful in evading price and other controls, and the number of commercial failures actually declined during the year. Prospects for large business improved somewhat in October, however, with the appointment of Gomez Morales as Minister

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of Economy. One of his first moves was to relax price controls. Most manufacturers were permitted to pass on non-labor cost increases incurred during the previous 18 months, thus saving several firms from insolvency. Auto prices consequently advanced nearly 25%, steel prices 22.5%, clothing 42%, shoes 35%, and construction materials as much as 100% in some cases. While the easing of price controls stimulated confidence and helped normalize the distribution system, inflationary expectations have also been stimulated and renewed demands for wage hikes are likely.

3. Other shifts in Peronist economic policy have also improved business and investor confidence. Economy Minister Gomez Morales seems to be firmly committed to public sector austerity and has ordered major cuts in official expenditures for personnel and equipment. Nearly 700 employees in the economy and finance ministries have been discharged and cuts in other ministries are likely. In addition, officials have recently indicated that restrictions on foreign investment will be eased during the coming months in the hope of attracting capital inflows. Gomez Morales's ability to continue his economic program remains uncertain, however, since renewed labor demands, higher inflation, and pressure from vested interests in both the public and private sectors could force policy reversals.

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4. Output probably will grow at least 5% in 1975.

Investment will continue to come primarily from the public sector in support of the ambitious development program while private capital outlays, particularly those from abroad, continue to lag. The deepening world recession may hurt the trade balance somewhat late in the year, depressing manufactured goods exports while prices of manufactured goods imports continue to escalate. Nevertheless, the nation's external accounts should be in approximate balance for the year as grain exports again offset slumping meat and wool sales and the cost of oil imports. If, as appears likely, slackening orders from foreign customers and from the public sector increases the unemployment rate and the inflation rate climbs to 60% or more, labor pressure on the Peronist regime could force another reversal of policy, causing disruptions of production and renewed pressure on foreign investors.